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In The

Supreme Court of the United States

October Term, 1980

No. 80-2142

ANGELO C. PAPPALARDO, et al.,

Petitioners,

—against—

LEO M. SHORE,

Respondent,

—against—

PARKLANE HOSIERY COMPANY, INC., and HERBERT N. SOMEKH,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONERS

ARTHUR M. WISEHART
Attorney for Petitioners
Bar Building
36 West 44th Street
New York, New York 10036
(212) 730-0044

Of Counsel:
WISEHART, FRIOU & KOCH
CUCCIA & OSTER

Printinghouse Press – Bar Ass'n Steno Svc. (Appeals Section) 212-840-1891

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TABLE OF CONTENTS

	Page
Table of Contents.....	i
Table of Authorities.....	ii
Cases	ii
Articles and Treatises	iii
I	1
II	7
III	11
CONCLUSION	14

TABLE OF AUTHORITIES

Page

Cases

Coopers & Lybrand v. Livesay, 437 U.S. 463 (1978) 5

General Motors Corporation Engine Interchange Litigation, 594 F.2d 1126 (7th Cir. 1979), certiorari denied, 444 U.S. 870 ..... 11, 12

Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322 (1979)..... 1, 12

Pettway v. American Cast Iron Pipe Co., 576 F.2d 1157 (4th Cir. 1978), rehearing den., 581 F.2d 267, certiorari denied, 439 U.S. 1115 (1979)... 12, 13

SEC v. Parklane Hosiery Co., Inc., 422 F.Supp. 477, 482, 483-5 (S.D.N.Y. 1976) aff'd, 558 F.2d 1083 (2d Cir. 1977) 8, 9

Page

Articles and Treatises

Brudney and Chirelstein, "A Restatement of Corporate Freezeouts," 87 Yale L.J. 1354, 1366-8..... 13

I.

Respondents mis-state the issue posed by this petition when they contend that, through an oral communication with the Clerk of this Court, on an unspecified date, it was ascertained that the prior negotiation of the proposed settlement did not make moot the writ of certiorari previously granted.

The issue is not mootness; the issue instead is the value of the case. The respondents do not deny that the settlement was negotiated prior to this Court's review of the collateral estoppel issue in Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322 (1979). The liability of the defendants for securities fraud established by that determination obviously created a vastly different situation as to the

settlement value of the case -- but that value was not translated into any meaningful benefit to the members of the class. As far as they were concerned, the painstaking review by this Court in a precedent-setting decision was treated by class counsel as a nullity for settlement purposes.

Indeed, the attorney who argued the case in this Court, admitted as much in an affidavit of May 15, 1980, subsequently filed in the District Court. In that affidavit, Samuel K. Rosen, Esq., stated that the settlement previously agreed upon reflected "a substantial discount" of the value of the case. First among the reasons given for this discount was "the uncertainties of any possible appeal to the Supreme Court." (SA 101)

Mr. Rosen's affidavit goes on to say that, at the time the negotiation of the settlement agreement had been completed, "it was my belief that the defendants did not intend to expeditiously file a petition for a writ of certiorari to the Supreme Court." He then states that the action of defendants' attorneys in thereupon proceeding to file a petition for a writ of certiorari was an event "which to this day I do not fully understand...." (Ibid.) Mr. Rosen then concludes: "On several occasions I raised with defendants' then trial counsel the possibility of delaying the filing of the certiorari petition and the reply filing dates, as the Supreme Court's own rules permit, but was rebuffed in such efforts." (SA 102)

In view of the foregoing, the kindest thing that can be said about the last paragraph on page 11 of class counsel's brief herein is that it is grossly misleading. The settlement proposed most assuredly was arrived at prior to the granting, or even filing, of a petition for a writ of certiorari.

We are somewhat perplexed about what to make of the references to a discussion with the Clerk, in the briefs submitted by the Respondents. They are found at pages 11-12 of Respondent Shore's brief, and at page 12 of the brief for Respondents Parklane Hosiery Company and Somekh. In the first, the assertion is that the two attorneys spoke jointly with the Clerk, "and were told that the proposed settlement did not affect the status

or the scheduling of the appeal to this Court."

The Parklane-Somekh brief goes further and asserts that "We inquired whether in these circumstances the Court would be willing to postpone its hearing of the case inasmuch as approval of the settlement would make the appeal moot. The Clerk advised us that no such postponement was available and that the appeal would be argued as scheduled."

Both briefs indicate that the advice attributed to the Clerk was consistent with Coopers & Lybrand v. Livesay, 437 U.S. 463 (1978).

Perhaps the most unusual aspect of these communications with the Clerk is the fact that not one word of the settlement situation, apparently, was dis-

closed in the briefs of either of the Respondents to this Court. The writ of certiorari was granted after the proposed settlement had been negotiated, and the briefs were filed substantially thereafter. Yet, apart from an oral communication to the Clerk, the Respondents went ahead and briefed and argued the appeal, so far as we are told, leaving this Court (except for the Clerk) entirely in the dark.

The investment of time and attention required to review an important and difficult case, having a widespread impact on the law throughout the United States, justifies criticism of attorneys who, because of a previously negotiated settlement that has only been mentioned orally to the Clerk, take the position that

the Court's decision on the merits in the case reviewed is without practical consequence -- that a "win" ostensibly on behalf of the class plaintiffs is to benefit them not one whit, notwithstanding the "substantial discount" reflected in the proposed settlement previously negotiated precisely because of the uncertainties of the outcome of an appeal to this Court.

II.

By a misleading reference to the decision in the stockholder's appraisal proceeding, utilizing figures unadjusted for interest and costs, class counsel's brief implies that not very much is at stake in monetary terms (p. 16). Not only are the figures used misleading,*

*It was not disputed at the argument before the District Court that the net value of what was offered was worth only about 70 cents per share as of the date when the company went private. (cont'd.)

but they contain no element of profit to defendant Somekh, for whose personal benefit the fraudulent freezeout was conducted.

Class counsel then contends that "petitioners introduced no evidence that Somekh made a profit." (p. 21)

However, the fact of profitability is established by the District Court's findings in the SEC action, where it clearly appears that the undisclosed but "overriding purpose" of the freezeout was for Somekh to avail himself of nearly $1 million of corporate funds to reduce his personal indebtedness. SEC v.

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*(cont'd. from previous page)
Tr. 6/27/80, SA 345. Moreover, this amount is based on the fact that proofs of claim to participate in the settlement fund were filed for only about half of the shares in the class. If more participated, of course, the pro rata recovery would be substantially reduced.

Parklane Hosiery Co., Inc., 422 F.Supp. 477, 482, 483-5 (S.D.N.Y. 1976), aff'd, 558 F.2d 1083 (2d Cir. 1977).

The purpose was purely personal -- Somekh's indebtedness arising from a personal investment in a massive real estate development in Tulsa, Oklahoma. Somekh's total profits are not known.* But that is only because class counsel did not do his job, and admittedly conducted no discovery on the issue.**

Thus on known facts alone, under the proposed settlement, the corporation (not Somekh) would have to pay only $285,000 (in 1981 dollars) for a securities

*The economic boom in Tulsa, Okla., is commented upon in a feature item in the New York Times for June 3, 1978, p. 8.

**Tr. 6/27/80, SA 331.

fraud engineered to enable Somekh to use $1,000,000 in corporate funds (in 1974 dollars) to pay for his Tulsa real estate speculation. A by-product benefit of the transaction to Somekh was access to the corporate treasury to finance Somekh's personal litigation costs, which have been estimated to have exceeded another $1,000,000.

Moreover, class counsel did admit that inclusion of Somekh's liability for his profits would mean a "quantum jump" in the measure of damages (Tr. 6/27/80, SA 423) -- a "quantum jump" that concededly was not factored into the proposed settlement.

In view of the foregoing, the assertion of class counsel that there was no evidence that Somekh made a profit is ludicrous.

III.

The brief submitted on behalf of Parklane and Somekh asserts that "so far as our research shows, this Court has never reversed nor entertained appeals" from proposed settlements in class action litigations (p. 3).

If that assertion is indeed true, it is respectfully submitted that the pro forma review on appeal by the Second Circuit below, contrasted with the much stricter standard of the Seventh Circuit in the General Motors Corporation Engine Interchange Litigation, 594 F.2d 1126 (7th Cir. 1979), certiorari denied, 444 U.S. 870, brings into focus issues that warrant the attention of this Court, based upon the following considerations:

(a) the fact that the proposed settlement constitutes an incentive for rather than a deterrent of securities fraud. This is shown by the analysis above of known benefits received by defendant Somekh -- a result that certainly was not within the contemplation of this Court when it decided Parklane Hosiery Company, Inc. v. Shore, 439 U.S. 322 (1979);

(b) The fact that only this Court can provide authoritative guidance in response to the rising crescendo of questions from throughout the country regarding the proper duties and responsibilities of class action counsel in a settlement situation -- in addition to the General Motors Engine Interchange case by the Seventh Circuit, supra, see Pettway v. American Cast Iron Pipe Co., 576 F.2d

1157 (4th Cir. 1978), rehearing den., 581 F.2d 267, certiorari denied, 439 U.S. 1115 (1979); and

(c) The serious difficulties, with due process dimensions, of attaining fairness to the public stockholders in corporate freezeouts -- see Brudney and Chirelstein, "A Restatement of Corporate Freezeouts," 87 Yale L.J. 1354, 1366-8 (concluding that in a freezeout situation, because of the control exercised by entrenched managements, like Somekh's, "the problem of implementing a fairness standard comes close to being insurmountable.").

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

ARTHUR M. WISEHART
Attorney for Petitioners
Bar Building
36 West 44th Street
New York, New York 10036
(212) 730-0044

Of Counsel:
Wisehart, Friou & Koch
Cuccia & Oster